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RESEARCH ARTICLE

Push Factors Affecting Tourism FDI in Sri Lanka

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Abstract

This study investigates the influence of home-country push factors on Foreign Direct Investment (FDI) inflows into Sri Lanka's tourism sector. While Sri Lanka has experienced growth in tourism arrivals, FDI into the tourism industry has not kept pace, prompting a deeper examination of determinants beyond host-country conditions. Employing a mixed-methods approach, the study integrates time-series data for Sri Lanka (1977-2023) and panel data from ten FDI-generating countries. Econometric analyses using Vector Error Correction Models (VECM) and panel regressions reveal that economic, regulatory, and geopolitical conditions in home countries significantly impact outbound FDI flows. The findings contribute to the academic discourse by emphasizing the importance of integrating both supply-side and demand-side determinants in FDI research and offer actionable policy recommendations for improving Sri Lanka's investment appeal.

Key Words: *Tourism FDI; Push factors; Sri Lanka; Bilateral agreements; Economic conditions; VECM; Panel data*

1. Introduction

Foreign Direct Investment (FDI) plays a pivotal role in bridging capital gaps and promoting economic development in emerging economies. Within the context of tourism, FDI contributes not only financial resources but also management expertise, technology transfer, and global marketing capabilities. For a developing country like Sri Lanka, which is strategically positioned and blessed with natural beauty, tourism has become a vital sector. However, despite a post-war surge in tourist arrivals and liberal investment policies, the country has struggled to attract commensurate FDI into its tourism sector. This disconnect highlights the need to investigate determinants of FDI beyond traditional host-country variables.

FDI in the tourism sector is increasingly recognized as a catalyst for sustainable development, job creation, and regional integration. The global tourism industry has become a competitive battleground for attracting capital, and Sri Lanka's regional peers such as Maldives, Thailand, and Vietnam have succeeded in creating more investor-friendly ecosystems. This discrepancy necessitates a focused inquiry into what Sri Lanka may be lacking or could improve in its policy and institutional environment.

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Conventional wisdom has long focused on factors such as political stability, market size, and infrastructure in the host country as primary drivers of FDI. Yet, recent research underscores the significance of push factors from the investor's home country. These include macroeconomic conditions, credit availability, policy incentives, geopolitical considerations and firm-level motivations. Particularly in the tourism sector, where investment decisions are influenced by a complex matrix of global and regional dynamics, the role of these push factors has remained underexplored in the academic literature.

Understanding push factors becomes critical in the post-pandemic recovery landscape, where capital allocation decisions are becoming increasingly cautious and driven by home-country fiscal and monetary conditions. Moreover, the interplay of global shocks, such as supply chain disruptions and geopolitical conflicts, reinforces the necessity of studying bilateral determinants of FDI.

This study aims to fill this gap by conducting a dual analysis of demand-side (host country) and supply-side (home country) factors affecting tourism FDI in Sri Lanka. It also seeks to position Sri Lanka relative to competing developing economies in Asia and beyond. By adopting a robust analytical framework and leveraging longitudinal and cross-country data, this research contributes to a nuanced understanding of FDI dynamics in the tourism sector.

2. Literature Review

FDI theories have evolved significantly, starting from the classical Heckscher-Ohlin model to more nuanced approaches like the Eclectic Paradigm by Dunning (1993) [1]. Dunning's OLI framework—ownership, location and internalization—has been widely adopted in explaining multinational enterprises' investment decisions. Within this framework, push factors correspond closely with ownership and internalization advantages that originate from the home country.

Research by Blázquez-Salom, et al. [2] examined foreign investment in tourism and highlighted theoretical gaps, especially regarding the influence of investor country conditions. Their work suggests that beyond host-country attractiveness, FDI in tourism is strongly influenced by international capital flows and the strategic motivations of firms.

Another vital theoretical construct is the gravity model, which postulates that economic interactions are directly proportional to economic size and inversely proportional to distance. This has been instrumental in explaining FDI patterns, particularly when cultural, geographic, or linguistic ties reduce perceived risks.

The Institutional Theory also gains relevance in explaining tourism FDI, particularly in how regulatory coherence, corruption levels, and legal transparency in both home and host countries influence investor confidence. Recent studies such as those by Goryakin, highlight the role of institutional trust in facilitating or deterring investment decisions, particularly in volatile sectors such as tourism [3].

Empirical studies, however, have often prioritized firm-level data, leaving macroeconomic analyses of FDI patterns at the national level relatively scarce. OECD and UNCTAD provide foundational datasets, but comprehensive national-level studies integrating both push and pull factors remain limited [4,5]. The World Bank's macroeconomic indicators have further

enabled broader econometric analysis across countries, especially in evaluating credit environments, trade openness, and governance quality [6].

Recent empirical evidence strongly supports the inclusion of Economic and Business conditions (EB) as critical push factors. Imran, et al. [7], using a global panel, confirmed that home-country GDP growth and institutional quality significantly impact FDI outflows. Vučković, et al. [8] emphasized that a stable business environment enhances investor confidence, even for outbound investment.

For the Regulatory Framework (RG), institutional quality indicators such as government effectiveness and control of corruption were found significant in Meressa, reinforcing their role in both inward and outward FDI [9]. Similarly, Jardet demonstrated that home-country uncertainty diminishes firms' capacity to expand abroad, supporting the Policy Risk (PR) construct [10].

The Availability of Finance (AF) has emerged as a key determinant in recent financial literature. Dellis, et al. [11] highlighted that well-developed domestic financial markets ease credit access, enabling firms to pursue international investment strategies. This directly justifies the AF variable in the supply-side framework.

While bilateral agreements (AG) have traditionally been discussed from a host-country perspective, Faruq and UNCTAD provide evidence that trade openness and international treaties also incentivize firms in source countries to seek outward FDI opportunities [5,12]. Finally, although the Cost of Production (CP) is less directly treated in recent macro studies, it remains a valid construct for capital-exporting countries where firms seek efficiency-seeking FDI destinations like Sri Lanka.

In conclusion, the post-2015 literature reinforces the relevance of existing supply-side variables, while offering updated empirical validation. These contemporary studies ensure the conceptual framework in this study remains robust and aligned with current global FDI trends.

3. Theoretical Framework

The theoretical underpinning of this study rests primarily on the eclectic paradigm (OLI framework), institutional theory and the gravity model. These theories collectively explain the behavior of Multinational Enterprises (MNEs) by linking firm-level advantages with macroeconomic and institutional conditions in both home and host countries. Their integration provides a robust foundation for analyzing supply-side determinants of tourism-related FDI.

The eclectic paradigm (OLI model), developed by Dunning, is particularly applicable to international tourism investment [1]. The "Ownership" component reflects firm-specific advantages that originate from the home country—such as capital reserves, brand value and managerial capacity. The "Location" component typically emphasizes host-country attributes, while "Internalization" captures the firm's strategic decision to control operations abroad rather than licensing. In this framework, push factors such as economic strength, financial stability and regulatory clarity in the home country enhance ownership and internalization advantages, thus enabling outward FDI.

Institutional theory posits that firms are embedded within institutional environments that shape their international strategies. Strong institutions in the home country—measured by legal transparency, regulatory quality and political stability—enable firms to operate confidently and invest abroad. Conversely, high domestic policy risk may either encourage capital flight or disincentivize risk-taking, depending on sectoral sensitivity and firm resilience.

The gravity model of international investment complements the above theories by introducing economic mass and distance into FDI behavior. While this model has traditionally focused on trade, it is now widely applied to FDI flows. In this context, home-country economic size (GDP) and proximity to the host country (geographic, cultural, or institutional) increase the likelihood of investment. For instance, large and open economies like the United States, Germany and India are more likely to invest outward due to surplus capital, global integration and institutional maturity.

Recent scholarship also incorporates the Resource-Based View (RBV), suggesting that firms seek to deploy or augment their existing resources internationally. For tourism firms, access to capital, marketing channels and skilled labor in the home country provide a foundation for global expansion. These motivations are often shaped by macroeconomic stability and access to finance, aligning with variables such as EB and AF in this study.

The theoretical framework thus justifies the inclusion of the six key supply-side variables:

- EB (Economic and Business Conditions).
- RG (Regulatory Framework).
- AF (Availability of Finance).
- PR (Policy Risk).
- AG (Bilateral Agreements).
- CP (Cost of Production).

Each variable is conceptually grounded in one or more of these theories, ensuring that the empirical model is both theoretically coherent and practically relevant to policy and investment analysis.

4. Methodology

This study adopts a mixed-methods approach, combining quantitative econometric analysis with qualitative validation to investigate the influence of supply-side (push) factors on tourism FDI inflows into Sri Lanka. The approach is structured in two main phases: (1) statistical modeling using time-series and panel data and (2) triangulation through expert surveys.

4.1. Data sources and sample selection

Two datasets were constructed for this study:

4.1.1. Time-Series dataset (1977–2023) for Sri Lanka: This includes FDI inflows into the tourism sector, macroeconomic indicators and tourism-related development variables. Data were obtained from the central bank of Sri Lanka, UNCTAD and the world bank's World Development Indicators (WDI).

4.1.2. Panel dataset (2010–2023) from ten FDI-source countries: Selected countries—United States, United Kingdom, Germany, Spain, Japan, China, India, Australia, France and the UAE—were chosen based on the following criteria:

- Historical FDI outflows into tourism sectors.
- Economic ties with Sri Lanka.
- Presence of globally active hotel brands and travel conglomerates.

Indicators used for each country include GDP growth, regulatory quality, credit to private sector, political risk index, bilateral agreements with Sri Lanka and cost-related metrics such as labour and inflation.

4.2. Variables and operationalization

Based on the conceptual framework, six independent variables were used to explain FDI behavior:

4.2.1. EB (Economic & Business Conditions): GDP growth rate, business confidence index.

4.2.2. RG (Regulatory Framework): World Governance Indicators (WDI) – Regulatory Quality (RQ).

4.2.3. AF (Availability of Finance): Domestic credit to private sector (% of GDP), interest rates.

4.2.4. PR (Policy Risk): Political stability index, economic policy uncertainty index.

4.2.5. AG (Bilateral Agreements): Number of active bilateral investment and trade agreements with Sri Lanka.

4.2.6. CP (Cost of Production): Average labour costs and inflation rates.

The dependent variable is TF—tourism-related FDI inflows to Sri Lanka, measured in USD millions annually.

4.3. Econometric modeling

To capture both long-run and short-run dynamics:

- Vector Error Correction Model (VECM) was employed for time-series analysis on Sri Lanka's domestic variables.
- Panel least squares regression (fixed effects and random effects) was used for the cross-country analysis, including Hausman testing to determine the appropriate specification.

Model diagnostics included:

- Wilks' Lambda and Pillai's Trace for multivariate significance.
- Variance Inflation Factors (VIF) for multicollinearity.
- Durbin-Watson statistics to test for autocorrelation.
- Residual normality tests to verify distribution assumptions.

4.4. Qualitative component

To supplement the quantitative findings, semi-structured surveys were conducted with:

- Senior officials from the Sri Lanka Tourism Development Authority (SLTDA).
- Investors from regional hotel chains.
- Consultants from investment promotion agencies.

Respondents provided feedback on regulatory bottlenecks, financial access and perceptions of bilateral ties with FDI-source countries.

4.5. Limitations

- Some panel data gaps due to inconsistent reporting across countries.
- Limited firm-level disaggregation within FDI flows.
- Potential endogeneity between policy risk and investment behavior.

Nevertheless, the triangulated approach enhances robustness and relevance, offering multi-layered insights into the determinants of tourism FDI.

5. Results

This section presents findings from both the econometric modeling and qualitative validation, providing a comprehensive understanding of how supply-side determinants in home countries influence tourism FDI inflows into Sri Lanka.

5.1. Multivariate test results

As shown in Appendix Table 4, the multivariate tests (Wilks' Lambda, Pillai's Trace, Hotelling's Trace, and Roy's Largest Root) indicate a statistically significant relationship between the set of supply-side variables and FDI outflows for all five modeled countries (United States, United Kingdom, Germany, Spain, Japan). For each country, the p-values were below 0.01, affirming the explanatory power of the selected independent variables.

5.2. Regression results by country

Appendix Table 5 presents coefficient estimates for the six supply-side variables across countries. The Economic & Business Conditions (EB) and Availability of Finance (AF) variables exhibited the strongest positive associations with FDI outflows (coefficients ranging from 0.27 to 0.31). Regulatory Framework (RG) also showed moderate positive significance (0.11 to 0.15), while Policy Risk (PR) demonstrated expected negative effects (-0.09 to -0.14).

Notably, Bilateral Agreements (AG) had positive coefficients (0.20 to 0.25), highlighting their role in reducing transaction costs and increasing investor confidence. The Cost of Production (CP) variable showed a modest negative association in most cases (-0.06 to -0.09), suggesting firms may seek cost efficiencies abroad.

The R-squared values for all country-specific regressions were high (0.83 to 0.88), indicating strong model fit.

5.3. Diagnostic statistics

Appendix Table 6 presents model diagnostics:

- VIF values ranged between 1.0 and 2.6, confirming low multicollinearity.
- Durbin-Watson statistics averaged around 2.0, suggesting no significant autocorrelation.
- Residuals passed normality checks ($p > 0.20$), indicating well-behaved model residuals.

These diagnostic results validate the robustness of the models.

5.4. Qualitative validation

Qualitative findings support the quantitative results:

- Stakeholders emphasized that financial ecosystem health and domestic political stability in the home country strongly influence outward tourism FDI decisions.
- Several respondents noted that bilateral agreements, particularly tax treaties and BITs, reduce perceived risk and incentivize long-term capital deployment in emerging destinations like Sri Lanka.
- Feedback also indicated that large hotel chains assess domestic cost pressures before evaluating overseas expansion.

6. Discussion

The results confirm that tourism FDI inflows into Sri Lanka are significantly influenced by macroeconomic and institutional conditions in the investor (home) countries. These findings align with emerging global literature that recognizes the dual role of both push (home-country) and pull (host-country) factors in shaping international capital flows.

Economic and Business Conditions (EB) were among the strongest predictors, reinforcing that macroeconomic stability, business confidence, and GDP growth in home countries enable firms to invest abroad. This aligns with studies by Imran, et al. [7], who argued that macroeconomic health facilitates outward investment by enhancing liquidity and investor optimism.

Availability of Finance (AF) also emerged as a critical driver. Developed financial markets, low interest rates, and credit access in the home country enable firms to take on international expansion projects. These findings echo Dellis, et al. [11], who found that robust financial systems in source countries are directly correlated with outward FDI.

Regulatory Framework (RG) and Policy Risk (PR) results supported institutional theory. Countries with consistent governance, transparent legal systems and low policy volatility are more likely to produce firms capable of committing long-term capital abroad. This corresponds with Goryakin and Meressa, who emphasized institutional stability as essential for FDI behavior [3,9].

Bilateral Agreements (AG) play a facilitative role. Faruq and UNCTAD highlight that treaties and agreements can reduce uncertainty and promote FDI by enhancing investor protection and dispute resolution mechanisms [5,12,13].

Although Cost of Production (CP) was negatively associated with FDI, its weaker statistical significance suggests that, in tourism, firms may prioritize market potential, brand positioning and bilateral relations over pure cost minimization. Tourism-related investments are capital-intensive and brand-sensitive, often focused more on strategic presence than short-term cost gains.

Finally, qualitative validation adds credibility to the econometric results. The alignment between model outputs and stakeholder insights suggests that home-country determinants are widely acknowledged in real-world investment decisions, even if underrepresented in earlier academic work.

7. Policy Implications

The findings present actionable insights for Sri Lankan policymakers and investment promoters:

7.1. Strengthen bilateral investment frameworks

Sri Lanka should prioritize the renewal and expansion of BITs with key source countries such as Japan, Germany, and India. These agreements should focus on investment protection, tax stability and simplified dispute mechanisms.

7.2. Target investment promotion activities

The Board of Investment (BOI) and SLTDA should tailor country-specific strategies based on FDI outflow potential. Countries with favorable EB and AF scores should be actively pursued at international investment forums.

7.3. Improve monitoring of global FDI conditions

Establish an FDI intelligence unit that tracks global trends—such as interest rate movements, political risk and credit conditions in target countries—allowing Sri Lanka to respond with timely policy adjustments.

7.4. Facilitate co-investment platforms

Collaborations with regional development banks (e.g., ADB) or global institutions (e.g., IFC) could create blended finance options, de-risking investment for foreign tourism operators.

7.5. Enhance perception of Sri Lanka as a strategic destination

Marketing campaigns should emphasize Sri Lanka's value proposition: lower entry barriers, growing tourism potential and improving regulatory stability.

7.6. Develop incentives based on investor origins

Tailor tax incentives and support packages based on the FDI source country's strategic profile, financial behavior, and past investment trends.

8. Conclusion

This study has examined the critical role of supply-side determinants—push factors originating in investor home countries—in shaping FDI flows into Sri Lanka's tourism sector. The analysis demonstrates that macroeconomic strength, financial system depth, regulatory stability, and bilateral engagement in home countries significantly influence the willingness and ability of firms to invest abroad.

The evidence shows that traditional FDI models focusing only on host-country attractiveness are incomplete. For sectors like tourism, where strategic expansion decisions are shaped by long-term risk and return calculations, conditions in the investor's domestic environment are equally, if not more, influential.

The six-variable framework—EB, RG, AF, PR, AG, CP—provides a coherent and empirically validated model for analyzing tourism FDI. The consistency of results across countries and alignment with stakeholder feedback reinforces the relevance of this dual-perspective approach.

For Sri Lanka, the implications are profound. To attract high-quality tourism FDI, the country must not only improve domestic conditions but also better understand and engage with source markets. This requires diplomatic, institutional and strategic foresight that aligns Sri Lanka's positioning with the evolving global investment climate.

As global uncertainties intensify and investment decisions become more complex, research that integrates home and host-country conditions will be essential for crafting effective FDI strategies. This study contributes to that evolving discourse and offers a roadmap for both academic inquiry and practical policymaking in the field of tourism investment.

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Appendix Tables (1977–2023)

Table 1: *Conceptualization of variables.*

Variable code	Variable name	Theoretical basis	Expected influence
EB	Economic & Business Conditions	OLI, Institutional Theory	Positive
RG	Regulatory Framework	Institutional Theory	Positive
AF	Availability of Finance	Resource-Based View	Positive
PR	Policy Risk	Institutional Theory	Negative
AG	Bilateral Agreements	Gravity Model, Institutional Theory	Positive
CP	Cost of Production	Eclectic Paradigm	Negative

Table 2: *Operationalization of variables.*

Variable	Indicators	Data source
EB	GDP growth rate, business confidence index	World bank, OECD
RG	WGI – regulatory quality	World bank
AF	Credit to private sector (% of GDP), interest rate	World bank
PR	Political stability index, policy uncertainty index	World bank, IMF
AG	No. of BITs & trade agreements with Sri Lanka	UNCTAD, WTO
CP	Labor cost, inflation rate	ILO, World bank

Table 3: *Summary of econometric models used.*

Model	Purpose	Techniques used
VECM (Sri Lanka time series)	Analyze long-run and short-run domestic determinants	Johansen cointegration, error correction model
Panel Regression (10 Countries)	Cross-country analysis of FDI outflows	Fixed effects, random effects, hausman test
Diagnostics	Test model validity and robustness	VIF, durbin-watson, residual normality (Shapiro-Wilk)

Table 4: *Multivariate test results.*

Country	Wilks' lambda	Pillai's trace	Hotelling's trace	Roy's largest root	Significance (p-value)
United States	0.003	0.992	11.52	8.94	0
United Kingdom	0.008	0.984	10.87	7.85	0
Germany	0.005	0.987	11.23	8.33	0
Spain	0.01	0.98	9.76	7.41	0.001
Japan	0.004	0.989	11.09	8.21	0
China	–	–	–	–	–
India	–	–	–	–	–
France	–	–	–	–	–
Australia	–	–	–	–	–
UAE	–	–	–	–	–

Table 5: *Regression results by country.*

Country	EB coef	RG coef	AF coef	PR coef	AG coef	CP coef	R-squared
United States	0.21	0.14	0.31	-0.1	0.25	-0.08	0.87
United Kingdom	0.18	0.12	0.29	-0.12	0.22	-0.07	0.85
Germany	0.23	0.15	0.3	-0.09	0.24	-0.09	0.88
Spain	0.16	0.11	0.27	-0.14	0.2	-0.06	0.83
Japan	0.19	0.13	0.28	-0.11	0.23	-0.08	0.86
China	–	–	–	–	–	–	–
India	–	–	–	–	–	–	–
France	–	–	–	–	–	–	–
Australia	–	–	–	–	–	–	–
UAE	–	–	–	–	–	–	–

Table 6: *Diagnostic statistics.*

Country	VIF range	Durbin-Watson	Residual normality (p-value)
United States	1.2–2.5	1.95	0.234
United Kingdom	1.1–2.3	2.02	0.289
Germany	1.3–2.6	1.91	0.215
Spain	1.0–2.1	2.05	0.301
Japan	1.2–2.4	1.98	0.265
China	–	–	–
India	–	–	–
France	–	–	–
Australia	–	–	–
UAE	–	–	–